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VZ - Verizon Communications Inc Completes Acquisition of VOD Ownership Stake in VZW

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OVERVIEW:

VZ acquired Vodafone's 45% interest in Verizon Wireless.

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PRESENTATION

Operator

Good morning and welcome to the Verizon investor conference call following completion of its acquisition of Vodafone's owner stake in Verizon Wireless. At this time all participants have been placed in a listen-only mode and the floor will be open for questions following the presentation. (Operator Instructions). Today's conference is being recorded. If you have any objections, you may disconnect at this time.

It is now my pleasure to turn the call over to your host, Mr. Michael Stefanski, Senior Vice President, Investor Relations.

Michael Stefanski - *Verizon Communications, Inc. - SVP of IR*

Good morning and welcome. This is Mike Stefanski and with me today are Lowell McAdam, our Chairman and Chief Executive Officer, and Fran Shammo, our Chief Financial Officer. Thank you for joining us on the first day of trading for the new Verizon.

The transaction to acquire Vodafone's 45% interest in Verizon Wireless closed on Friday, February 21. As part of the total consideration, approximately 1.275 billion shares of Verizon were issued and delivered to the shareholders of Vodafone. The majority of the rest of the deal consideration was in cash which was previously secured with permanent financing.

As of the close of the transaction on Friday, our gross debt was approximately $114 billion. We expect our gross debt to be approximately $110 billion by the end of the quarter.

Before I get started I wanted to point out that our press release and the presentation slides for today's call and webcast are available on the investor relations website. A transcript and replays will be made available on our website.

I would also like to draw your attention to our Safe Harbor statement. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties. Discussion of factors that may affect future results is contained in Verizon's filings with the SEC which are also available on our website.

This presentation contains certain non-GAAP financial measures; reconciliations of these non-GAAP measures to the most directly comparable measures are available on our website.

I would now like to turn the call over to Lowell McAdam.

Lowell McAdam - *Verizon Communications, Inc. - Chairman and CEO*

Thank you, Mike. Good morning to all of you on the call today. I appreciate you joining us. Today is in fact a historic day for Verizon. We would like to also welcome our new and existing shareholders across the globe.

Since we announced this transaction in early September, we have focused on explaining our strategy and our perspectives on the industry. We believe in the health and the vibrancy of the wireless market in the United States. We have one of the strongest economies in the world, a good competitive framework and lower penetration rates than many other parts of the world.

Full ownership of our wireless asset is a major milestone for Verizon. From a strategic perspective, it enhances our ability to deliver the integrated data and video services that will change the game for customers and create new growth opportunities for the future. Financially the benefits are straightforward. It is immediately accretive to earnings per share and provides access to all of the wireless cash flows. There is no integration risk because we manage and control this business completely today.

Retaining all of the wireless cash flows gives us the ability to continue to steadily invest in our networks and spectrum, meet evolving customer requirements for products and services and take advantage of many new growth opportunities across all of our networks and platforms. Importantly, our financial strength will allow us to pursue these growth opportunities in a profitable manner.

The wireless industry in the United States has always been very competitive and certainly over the past several quarters, we have seen competitors introduce new offers and advertise aggressively. These competitors are also increasing investment in their networks which is good overall for the industry. We are very confident in our competitive position and continue to play to our strength which is our network.

Our network leadership has been built on years of consistent investment in the technologies that enable the products and services that customers want. We completed our nationwide 4G LTE coverage build halfway through last year and since then have been adding capacity and depth to our network. We are rapidly deploying our AWS spectrum throughout the nation starting with our most dense urban markets to handle the tremendous usage growth we are experiencing.

There is no better example of our network advantage and leadership than our performance at the Super Bowl earlier this month where we handled 800% more usage than we had during last year's game and three times more than our nearest competitor. We also successfully demonstrated new uses of the LTE network using multi-cast technology.

We have consistently played our game and proven that we can act quickly when warranted to effectively compete and deliver high-value for customers and profitable growth for our shareholders.

We have a near-term opportunity for growth related to wireless connectivity. With 70% penetration of smartphones, we still have 25 million basic phones in our postpaid connection space. About 25 million of our smartphone customers are still using 3G devices. So there is certainly upside in getting these customers into a 4G device.

Tablets present a great opportunity. We currently have 3.6 million tablets within a base of 35 million customer accounts and nearly 97 million postpaid devices. So it is easy to see that further tablet penetration is yet another growth opportunity.

In order to drive further penetration of 4G devices, we recently introduced our More Everything plans. They are designed to further enhance our customer value proposition giving customers what they want, simplicity and increased value. These new plans provide more value through simplified data allowances and more choice for customers. More Everything customers now receive cloud storage and international messaging as part of their plan. Our customers now get a choice of two-year service contracts or the Verizon Edge, which is for customers who may want to upgrade more often and more quickly.

We listen to our customers. We have always done that going back to the formation of Verizon Wireless when customers were looking for seamless national coverage. We have a track record of implementing well conceived comprehensive go-to-market plans that present a strong value proposition for customers and drive service, revenue growth and profitability for the business.

Our new pricing plans provide a framework to drive further penetration of 4G smartphones and tablets and stimulate usage on a more efficient 4G LTE network. We have the ability to effectively monetize this usage driving growth and service revenue and profitability.

I have had the chance to speak with many of you over the past six months about the next phase of wireless growth. We believe that platforms and solutions create even greater opportunities to drive increased usage and extend value beyond connectivity especially mobile.

Many of these opportunities also include broadband and cloud-based services. We see expanding opportunities as mobile networks become the platform for most of the world's digital traffic. The quest to make digital information available to any device anywhere over wireless networks is giving rise to new business models such as mobile video delivery, machine-to-machine, security and cloud services, and mobile commerce. These business models cross several industry verticals such as automotive, telemedicine, energy management and others that are just developing.

We are really only just getting started when it comes to machine-to-machine and connected devices. No company is better positioned to take advantage of these opportunities than we are. I believe we have a unique asset portfolio to drive continued growth and value over our networks and create an integrated experience for our customers. The digital economy is clearly moving to mobile first on everything which means there are many growth opportunities to pursue.

These opportunities are more powerful with a mobile component and having that freedom that comes with full ownership is critical to us at this time.

We have spent several years transforming ourselves into the new Verizon, a Company that can provide integrated solutions to meet the increasingly complex requirements of customers in the digital economy. Our network capabilities are vast and include our industry-leading 4G LTE network, our world-class FiOS network, our high-speed global IP backbone networks, which together give us a distribution system for delivering innovation at a large scale.

Now through acquisitions such as Terramark, Hughes Telematics, CyberTrust and our recent moves into video delivery space, we have a robust portfolio of broadband, video, machine-to-machine, cloud, and security services that can be delivered over any of these networks to any device wherever customers need them.

The new Verizon is positioned to pursue these growth opportunities even faster. We will be focused on producing more seamless and integrated products and solutions for customers across the consumer and enterprise markets.

A few weeks ago we established a new Company-wide product development and management organization. The purpose of this group is to leverage all of the Verizon assets to develop innovative products quickly and to manage the lifecycle of all of our product offerings. They will have responsibility for developing new and emerging business models and ecosystems in the areas of machine-to-machine and video distribution including those that will use the recently acquired assets on OnCue, EdgeCast and upLynk.

Marni Walden, who was formerly the Chief Operating Officer of Verizon Wireless, will lead this new organization and report directly to me.

In short, we are very excited about the future and extremely confident that sole ownership of Verizon Wireless will enhance our overall growth prospects. In the meantime we will remain as focused as ever on those things that have made us the market leader, those being network quality, customer service, product innovation and rigorous execution around our financial and operating metrics.

I will now ask Fran Shammo, who as many of you know is our Chief Financial Officer, to discuss our financial outlook for 2014.

Fran Shammo - *Verizon Communications, Inc. - EVP and CFO*

Thanks, Lowell. Good morning, everyone. As I stated on our earnings call last month, we entered 2014 with confidence in our ability to take advantage of the growth opportunities in our key strategic markets. As always our networks provide the fundamental strength upon which we build our competitive advantage. We will continue to steadily invest in our networks and platforms to fuel innovation and create future growth opportunities.

Now that the transaction has closed, we are able to provide more financial information related to our outlook for the business in 2014.

At the consolidated level, we are targeting 4% topline growth this year demonstrating our ability to sustain an overall revenue growth rate similar to 2013 when we grew 4.1%. In terms of profitability, we expect to expand our consolidated EBITDA margin. Last year we posted an adjusted margin of 34.9% so we are planning to drive a higher result in 2014. In support of this objective, we are targeting increases in EBITDA and higher margins in both the wireless and wireline segments.

Since we have already been consolidating the Verizon Wireless results, the important changes to our income statement post transaction will happen below the operating income line. As a guide, I refer you to our S-4 prospectus and the UK circular documents which contain pro forma results for the nine months ended September 30, 2013.

Let's walk through these line items one at a time. Equity in earnings of unconsolidated businesses; this line item totaled $142 million in 2013 and included $211 million in equity income from our 23% interest in Vodafone Omnitel. Going forward, our equity in unconsolidated businesses will be reduced based on the sale of this minority stake.

Interest expense; Mike provided our gross debt at the close and our weighted average interest cost is approximately 5%. The details of our outstanding bonds and their respective coupon rates are posted on our website so you should be able to properly estimate both the incremental deal-related interest and the new interest expense run rate based on publicly available information. You can also use the nine-month year-to-date pro forma as a guide.

Income taxes; as we stated last September, the effective tax rate will be 35% to 36% based on the additional income we will recognize from 100% ownership of Verizon Wireless. This increase in pretax income comes without any tax preference items to speak of so our ETR will move much closer to statutory tax schedule and state tax rates.

Net income attributable to noncontrolling interests; this line item which previously included Vodafone's 45% equity stake in Verizon Wireless will be reduced to the remaining noncontrolling interest in certain wireless markets. We still have over 70 wireless markets that have minority interest components. Using our nine-month year-to-date 2013 pro forma as a guide, you will see that net income associated with these noncontrolling interests amounted to approximately $400 million in 2013.

Lastly, you need to account for the additional shares issued in connection with the transaction. On a pro forma basis, our shares will be approximately 4.1 billion.

As we have consistently stated, the transaction will be accretive to earnings per share by about 10%. To determine a baseline or jump-off point the first thing to do is take our 2013 adjusted earnings per share of $2.84 per share and add the 10% accretion which you will also see reflected in the pro forma income statements in our filings. This will get you to a jump-off point for 2014 financial projections.

In thinking about our 2014 results, it is important to keep in mind that the deal closed on February 21 so for the first quarter, we will have 7.5 weeks at 55% ownership of Verizon Wireless and just over five weeks with 100% ownership. In addition to the immediate earnings accretion, the other obvious financial benefits of the transaction is full access to all the cash flows.

Let's move next to our outlook on the sources and uses of cash as well as some geography changes to our statement of cash flows. From our overall cash perspective, the incremental free cash flow generated by Wireless will fully fund the transaction.

Our priorities for uses of cash in 2014 are essentially unchanged. We will continue to invest in our networks, purchase spectrum and delever the balance sheet in a prudent and disciplined manner. We do not need to execute any major acquisitions to drive our business model. We understand the importance of our dividend policy and its role in delivering value to our shareholders.

As you know, our Board of Directors has shown its support by approving dividend increases in each of the last seven years.

In terms of mapping, the most notable difference will be in the bottom section of the cash flow statement where we report cash flows from financing activities. There are a couple of significant cash outlay benefits to keep in mind.

First and most obviously, there will be no more special distributions from Verizon Wireless to Vodafone. You will recall that their share of the $7 billion distribution in 2013 was $3.15 billion.

Secondly, tax distributions to Vodafone will cease after February 21. In 2013, these distributions amounted to $4.5 billion. For reference, these distributions were reported as part of the other net line item in the financing section. There will be a tax distribution made in arrears in February covering the fourth quarter of 2013 and a final one for the stub period January 1 through February 21 of this year.

There are also a few changes to expect in the cash flows from operating activities section of our cash flow statement. In addition to the incremental interest expense and the sale of Omnitel, we did indicate on our earnings call last month that our minimum required pension funding for 2014 will be a $1.2 billion based on our current plan assumptions.

In terms of cash taxes, we have stated all along that we expect them to be higher in 2014 as a result of the additional pretax income from Verizon Wireless and to a much lesser degree due to bonus depreciation not being extended.

So in terms of geography, the $4.5 billion in tax distributions to Vodafone in the financing activities will now be part of a reduction in cash flow from operations since the cash taxes will be paid directly to the government. As a result, cash flow from operations will decrease by the amount along with other cash tax increases.

Keep in mind that while we expect cash taxes to increase, it does not necessarily mean it will be an incremental cash outlay as we will no longer have either special or tax distributions to Vodafone.

Because there seems to be some confusion about the impact of bonus depreciation, I will tell you that the absence of new deferred tax benefits under this program results in about $1 billion of incremental cash tax in 2014. A majority of prior deferrals under this program will reverse over the next three years.

In January, we talked about capital spending indicating an expected range of between 16.5 billion and $17 billion compared with $16.6 billion in 2013. Importantly, our annual CapEx to revenue ratio will continue to show improvement as we continue to drive better returns on our invested capital.

Let's move next to our summary slide then we can get to your questions. As you have heard me say many times at the end of the day, it is all about execution. We are coming off a great year in 2013 from both a strategic and financial performance perspective. Our focus on the customer and improving their value proposition drove consistent topline performance and resulted in a strong growth in profitability and cash flows.

We enter 2014 very confident in our ability to generate strong financial performance driven by sustained 4% topline growth and expansion of our consolidated EBITDA margin. As I said earlier, both wireless and wireline will positively contribute to profitable growth.

We continue to focus on generating operating and capital efficiencies and will maximize and manage our cash flows to retain the financial flexibility to invest in our future, deliver results that meet our financial objectives, and return value to our shareholders. We look forward to another great year in 2014.

With that I will turn it back to Mike so Lowell and I can get to your questions.

Michael Stefanski - *Verizon Communications, Inc. - SVP of IR*

Thanks, Fran. Brad, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Michael Rollins, Citi Investment Research.

Michael Rollins - *Citigroup - Analyst*

Good morning. Thanks for taking the question. Curious if you could talk a little bit more in response to a press report that came out on Friday that the Company would be making some changes in the coming weeks quoting an internal memo of yours, Lowell, talking about repositioning the Company. And I was curious if you could talk a little bit more detail about what that means and what you are looking to accomplish in some of the changes that the Company could be making.

At the same time if you can give us an update on the cost-cutting opportunities or cost-cutting goals for wireless and wireline in the same way that last year you outlined a cost-cutting goal for the wireless business? Thanks.

Lowell McAdam - *Verizon Communications, Inc. - Chairman and CEO*

Okay, Mike. Good morning. Thanks for your question. So the first one around any organization structure, I think it all ties back to the reason that we did the deal to begin with is that we see the market in the US requiring using all the assets that we have in converged services. So using our cloud assets with our telematics and machine-to-machine assets along with mobile and FiOS, etc.

The first move will be a continuation of what I alluded to and that is creating our product development and innovation organization. Part of that organization will be to move what we call emerging business opportunities into that organization. I think of it as a little bit of an incubator so as these smaller companies get fully developed and their roadmap gets fully developed and the technology gets fully developed, they are in an environment where they have a lot of nurturing and feedings. So that will be the second thing.

The next thing I think is opportunities for us to further streamline the business and to get to leverage synergies. It leads a little bit into your question of VLSS or what we call Verizon Lean Six Sigma. We have had that process in place now for about three years. Last year we took about $5.7 billion out of our cost structure. That target will go up next year and as we have had literally hundreds of these projects underway, we have shown processes that need to be revamped and when you look at these processes and in my view the structure comes behind it.

So I will just pre-position this a little bit. Not a lot of changes on the wireless side, more in the infrastructure that supports the two businesses. But we also see opportunities to streamline our wireline side of the business and as you know from our previous discussions together, we have been working on retooling our enterprise services organization for the last couple of years and the systems work is now virtually done. We are moving a large percentage of our provisioning and maintenance activities through this new process and so the structure will follow that.

Operator

David Barden, Bank of America Merrill Lynch.

David Barden - *BofA Merrill Lynch - Analyst*

Thanks for taking the question. Lowell, just as a starting point, as we have talked about the Verizon Vodafone deal for some time now, it has long been said that Verizon really hasn't been able to not do anything that it wanted to do as a result of the partnership with Vodafone. But obviously these organizational changes and Marni's new position suggests that there are things that you do want to do now with the margin that are new. Could you kind of map out what we can expect and over what timetable we can expect it that is going to be new to the Verizon outlook?

And if I could, Fran, just one quick one. Lots of moving parts on the cash flow side obviously spectrum aside, can you kind of tell us looking through the deleveraging lens how long you think it takes before you get to the point where the cash flow is now going to go to the equity holders opportunity for reinvestment and such rather than the debt holders? Thanks.

Lowell McAdam - *Verizon Communications, Inc. - Chairman and CEO*

So I will start out and then Fran can answer the second part of your question. As you indicated, Vodafone never really stopped us from doing anything. They were great partners and became great friends so there is no issues there. Just what we saw is the landscape of the US market changing pretty significantly and we had a very different set of assets and a very different economic environment than Vodafone does mostly concentrated in Europe.

So the biggest change for us is speed. You will see the product portfolio evolve pretty quickly here. We have been talking about machine-to-machine or what now everyone seems to refer to as the Internet of Things; we have been talking about that for 10 years. But I think with LTE and with these machine-to-machine platforms such as our Hughes Telematics platform really coming of age, we think we can really deliver these now.

I would also say that regardless of how you feel about the Affordable Care Act, that disruption is going to have a huge opportunity for those of us in this business to provide those sorts of connected devices that will improve people's health care.

Also I think you and I have talked about this but you see the energy grid and the smart transportation system changing so we see dramatic changes there this year and next year.

Then the secondary I would highlight before I hand it to Fran is around video. Now you have seen our acquisition portfolio over the last few months. EdgeCast and upLynk help our what we call our Verizon Digital Media Service. That is a content delivery network growing very strongly for us, getting a lot of good adoption from our customers. And then our OnCue purchase that we just completed last week gives us the opportunity to do IP TV within the FiOS footprint and we are having a lot of discussions with the big content providers now and that could turn into a much bigger platform for us over time. In fact, we hope it does.

So those are the two areas that you will see us move into very, very quickly during the next 12 to 24 months.

Fran Shammo - *Verizon Communications, Inc. - EVP and CFO*

Thanks, David. So on your question on the cash flow, so let me just be consistent again with what we have said. We have four major priorities here for cash over the next two to three years. One is the spectrum purchase which I said we will absolutely be in the market for spectrum. The auctions are coming up here at the end of 2014 into 2015 and of course, we continue to play in the secondary market. So spectrum is obviously something that we are going to need to acquire for the next five to 10 years.

Network and platforms as you have heard Lowell speak about, we will continue to invest vigorously in these networks and platforms. Then of course as I said before, our goal is to return to an A-rated Company profile with the rating agencies within four to five years so debt reduction will be a priority of ours and then I reiterate the dividend policy is something that is very important to us.

You are getting to a question of share repurchase and I said, as I said publicly before, I would not anticipate any share repurchases at least in the next two to three years. I think it would be hard for us to financially justify everything else we are doing with the amount of debt we have and the reduction and our goal to return to that A- profile. So I think that lays out a pretty strategic nature of how we are going to utilize our cash flow.

Operator

Simon Flannery, Morgan Stanley.

Simon Flannery - *Morgan Stanley - Analyst*

Great. Thank you very much. I was wondering if you could talk a little bit about installment plans in the Verizon Edge and how does that play into your guidance? Have you see much of a take-up there in terms of the margins and the free cash flow assumptions?

Then any commentary about momentum on the FiOS side for 2014. Are we going to see run rates pretty much like 2013 or any puts and takes there? Thank you.

Fran Shammo - *Verizon Communications, Inc. - EVP and CFO*

So on the guidance and how Edge iterates this. So part of us, as we have said before, we are concentrated on service revenue growth so that would exclude anything from an installment sale because that would go into total revenue so service revenue is the key to this business and that is what we are concentrating on.

So the guidance I have given you here from EBITDA margin expansion does not include installment sales. Now installment sales inherently will expand margins but we are really looking at the BAU from a guidance perspective.

The other thing I would point out too is you have a new revenue recognition policy that is going to be probably passed here very shortly and that is going to have a significant impact on margins but as everyone knows, that is just accounting not real economics of anything. So what we are really focused in is on the cash and the real profit generating. And at the end of the day, that is what we are focused on.

Now Edge will obviously have stronger take rates in 2014 as it did in 2013. That will improve my margins but what we are talking about here is an expansion really doesn't include any of that in it. This is a BAU and as Lowell said, really focused in on the cost structure of the businesses.

Lowell McAdam - *Verizon Communications, Inc. - Chairman and CEO*

So, Simon, on the FiOS growth as you know, we did about 600,000 last year. A couple of trends I think we are seeing broadband significantly outpace TV as we went to the latter part of the year. I think you are beginning to see more over the top play and we expect that that will continue into 2014. I think also we were at 35%, 40% market penetration. You have seen the competitive pressure in the marketplace kick up over the last couple of quarters. We are being very disciplined about this and make sure that the growth we have is profitable.

And I would tell you some of the priorities for us -- our existing optical network terminals that are in place and we think we can sell back into those and then areas like New York City where we can do a very short fiber extension and get into multiple dwelling units, those are the priorities for us as we move into 2014.

Operator

John Hodulik, UBS.

John Hodulik - *UBS - Analyst*

Maybe a question for Fran. There's lots of moving parts on all of the financial statements but as it relates to EPS, you stuck to the 10% accretion. Can you give us a sense for how it all adds up? We have got the 4% topline growth but what kind of underlying EPS we can expect sort of on top of the 10% accretion we are getting from Vodafone? Thanks.

Fran Shammo - *Verizon Communications, Inc. - EVP and CFO*

John, look, I am not going to give you specific guidance here on earnings per share. As I said, the jump off point of $2.84 at 10%, then you have to factor in what our growth would have been on a BAU basis of the 55% of wireless and then also the wireline margin. As I have said before and Lowell and I have both reiterated this, is that we are very confident that we can expand the wireline margin in 2014.

Now I will tell you that this is not going to be hundreds of basis points improvement, this will be a slow slope of improvement but as I said before, some of these headwinds that we have had will start to improve. Verizon Digital Media Services will start to contribute more to the bottom line. It has been negative up to this point. So Hughes Telematics is another one.

So wireline margin will continue to improve and then it is kind of obvious if we state that the overall margin of the business will improve, that means that wireless has to contribute more.

So look, I am not going to get into specific numbers around earnings per share and I think you guys can figure this one out based on all the information we gave you.

Operator

Mike McCormack, Jefferies.

Mike McCormack - *Jefferies & Co. - Analyst*

Thanks. Fran, maybe just a quick comment on recent pricing changes, anything we should expect from an ARPA impact on that throughout the year? And do you view that as just a sort of isolated incident or is this going to be an ongoing process of just tougher pricing for the industry?

Secondly, maybe your thoughts on why not embrace Edge in a more meaningful way given that it is basically a no subsidy model that should improve the margins over time? Thanks.

Lowell McAdam - *Verizon Communications, Inc. - Chairman and CEO*

Let me jump in and then Fran can add any particular comments he wants to. I think it is interesting given my years in the industry, how you hear things like price war and all that being kicked around in the media today and this is really nothing different than we have seen over the last couple of decades.

If I look at our Share Everything plans, that was in the market 19 months before we had to do a refresh on that and the only surprise there for me is that it took that long to happen. If you look at our recent changes at the $45 price plan, I don't really view that as a plan that is a long-term plan.

It is an entry point for most subscribers and then as they get on their smartphone, they are going to find that they need more data so they very quickly move up from that point but it was a gap for us so we filled it.

The More Everything plans, we saw an opportunity to streamline and add more data for the same pricing and that is a good thing for us. We have seen much higher adoption in tablets. And as I mentioned at David's question a few minutes ago, as you see machine-to-machine and you see more video come on, people are going to want to attach their devices to those bundles. So that was when we led the industry and brought in those bundle plans 19 months ago, that is exactly what we thought would happen.

As far as promoting Edge, Fran, maybe want to take some points on that. But that is really a customer choice. If they want to do it in an installment and they want the ability to upgrade more quickly, they have got that option. If they would rather pay a little bit less up front and have the two-year contract, that is perfectly fine. There are certainly some cash flow implications for us that we factor into our models but to me this is all about choice for the consumer and I think we have shown we have got the ability to react with the assets that we have.

Operator

Brett Feldman, Deutsche Bank.

Brett Feldman - *Deutsche Bank - Analyst*

Thanks for taking the question and just to follow-up on your answer to Simon. Fran, you mentioned that your outlook for improved wireless margins doesn't really rely on any accounting benefits associated with Edge. Could you just clarify whether you factor any of that into your revenue guidance?

Fran Shammo - *Verizon Communications, Inc. - EVP and CFO*

On that one, Brett, no, because it is service revenue growth. The installment sale actually is on the equipment side of the house so that would be part of total revenue. So we are really focused in on the service revenue growth and as you know, we produced an 8% growth in that metric in 2013.

As I said before, I think that we will continue to have strong service revenue growth, but I also said that over at least the short-term here and I would say whether that is the next eight quarters, that 8% will be hard to sustain over the longer term. So I would envision that that service revenue growth would start to decline a bit, but no, the installment sale side is not part of the service revenue growth.

Brett Feldman - *Deutsche Bank - Analyst*

And then just because Lowell was talking about the competitive environment, have you assumed that you are going to be increasing your marketing spend in wireless at all this year, or is it just steady as she goes?

Lowell McAdam - *Verizon Communications, Inc. - Chairman and CEO*

Let me take that one, Brett. I don't see an increase there, but what I do see is a shift. We are becoming much more comfortable with social networking and digital marketing and, frankly, more effective in where we put those dollars. So that is back to our cost reduction that Mike asked up front. Our VLSS, we have spent a lot of time on how to most effectively communicate with our customers and drive our subscriber traffic into distribution. So I don't see those dollars going up.

Operator

Amir Rozwadowski, Barclays.

Amir Rozwadowski - *Barclays Capital - Analyst*

Thank you very much, and thank you for taking the question. A lot of discussion has been focused on some of the recent price points as you have mentioned, Lowell. But I was wondering, as you make it more attractive for subscribers to migrate to LTE, can you talk a bit about the network efficiency that LTE provides you? And how much of that is a contribution to your overall expectations for margin expansion?

Lowell McAdam - *Verizon Communications, Inc. - Chairman and CEO*

Thanks. As you know, we have done a lot of investments in the network here just recently putting AWS in place and I talked about the impact of the Super Bowl so we feel very good about our position not only where the network is today but how we can evolve it going forward and people are really stepping up and using this.

Now with LTE, we see four to five times more efficiency and handling the megabyte of traffic so as we mentioned in the upfront dialogue we have got about a third of our customers that are still on basic devices and roughly a third of the devices that are on 3G even though they are smartphones. So we have the opportunity and that is all factored into the plans and the guidance that Fran gave you. But we've got the opportunity to move those people off of the less efficient network onto the 4G LTE network and then we will go and re-farm that spectrum and put it to use on 4G and 4G Advanced which we expect to see coming in the next 24 months.

So all that is factored in. Fran, I don't know whether you want to add anything to that?

Fran Shammo - *Verizon Communications, Inc. - EVP and CFO*

No.

Operator

Jonathan Schildkraut, Evercore.

Jonathan Schildkraut - *Evercore Partners - Analyst*

Great. Sorry to beat on this EIP topic a little more. But I'm just wondering, Fran, from our perspective because there were so many moving parts around this, does the shift to EIP create value for Verizon or is it simply a change in accounting?

Fran Shammo - *Verizon Communications, Inc. - EVP and CFO*

Well, I think you have to look at -- there's two fundamental models here. As Lowell said, it is a customer choice. But if you think about the subsidy model, this is a Company that has been in a subsidy model business for 14 years and we generated 49.5% margin in 2013 so the subsidy model is not a bad model for value creation and it is very appealing to our customers, it is very appealing for us.

The installment sale is just another method of payment and I think you have to remember that although it is "no subsidy", the economic model still has to bear itself out because you're going to be putting up a fairly large receivable on your books, you are really focused on the credit-worthiness of the customer to pay that receivable, and you are also looking at the residual value of the phone as to when they want to upgrade.

So I think it is too early to tell the economics here but obviously from a no subsidy standpoint on face value, it has very good economics. Put the accounting piece aside, the economics of that are fairly good. But again, we won't really bear this model out until we go the full two years on an installment sale.

And the other thing I would reiterate too is today you have an early termination fee on subsidy models. A fair number of customers, the majority of the customer who gets billed an early termination fee never pays that fee. So if you think about customers walking on the installment sale, if it follows the same pattern as an early termination fee then obviously the economics are not going to be as good at face value over the longer term. But again, it is going to be something that we are going to have to focus in on. We are going to be very concentrated on the credit-worthiness of the customers and who can qualify for this type of an installment sale.

But again, it all comes down to customer choice. We will make it financially work based on the pricing we have in the marketplace and obviously both models are good at this point for us so we will see how this plays out.

Michael Stefanski - *Verizon Communications, Inc. - SVP of IR*

Thanks everyone. That is all the time we have for questions. But before we wrap up, I would like to turn it back to Lowell for some closing comments.

Lowell McAdam - *Verizon Communications, Inc. - Chairman and CEO*

I thought you all might bring up the whole net neutrality discussion since that is so prominent in the news here lately. So let me say a couple of words about that and then I will close.

Obviously we are pleased with the court's decision. I think any clarity in this area that we get is a good thing and I think the court's decision helped with that. I know you have all seen Chairman Wheeler announced a notice of proposed rulemaking. We will be obviously heavily involved in that as we go through that process and we think that will provide additional clarity.

I think just a couple of statements though from me. We make our money by carrying traffic. That is how we make dollars and so to view that we are going to be advantaging one over another really is a lot of histrionics I think at this point. I think it is only natural that the heavy users help contribute to the investment to keep the web healthy. That is the most important concept about net neutrality.

And so we are pleased to see that Netflix and Comcast had an arrangement. We will have to see what the details of that are but we have had discussions with Netflix ourselves and feel that the commercial markets can come to agreement on these to make sure that the investments keep flowing.

As we look at broader rulemaking, I think it is important that we look at the very broad Internet players here. It is very easy to think that the Comcasts and the Verizons are really the gatekeepers of the Internet but there are many, many critical players here from Netflix to Apple to Microsoft to Google, the list just goes on and on. And I think that any rules will need to include all of these players but probably most importantly, to have a very light touch because this is a very robust and dynamic environment, the players are changing constantly, the uses of the network will be changing constantly.

As we talked about on the call earlier, everything from healthcare to telematics to the energy grid need to be balanced with someone who is trying to watch last year's episode of NCIS. So we are going to be encouraging a very light touch on the Internet to make sure that an investment in innovation continues.

But I am actually encouraged and that is the point that I wanted to make that we are beginning to get some clarity around these issues and we are looking forward to working with Chairman Wheeler on bringing these rules to conclusion.

So just a final few comments then as we close the call. Obviously we have been preparing for this day, the first day of the new Verizon for about the last 15 years and we have created a tremendously valuable wireless asset. We have built the financial strength and flexibility to finance this transaction in an accretive manner for our shareholders.

Our industry has a healthy competitive environment. It has been that way since the beginning and I expect it will continue. We are focused on innovating around the many opportunities in broadband, video, machine-to-machine and security and cloud services across our multiple networks. Our business has very strong fundamentals and significant growth opportunities ahead of us and I think we have got a solid track record of delivering consistently strong results in both growth and profitability and it has been based on as Fran says, a good execution of the game plan.

We will continue to be a very effective competitor in all of our markets. As always our focus is on providing a great customer experience and by reinforcing and evolving our superior networks. The value proposition and the efficient delivery of the services Fran and I are both confident will generate significant growth and profitability not only in 2014 but in years to come. And I think that that will create value and provide the earnings and cash flows necessary to invest in our networks and to innovate and deliver on what we say to our customers and also provide significant returns for our shareholders.

I thank you all for joining us on this first day of the new Verizon and we will look forward to sharing with you our first-quarter results when we get to that point in April. Thank you very much.

Operator

Ladies and gentlemen, that does conclude the conference call for today. Thank you for your participation and for using Verizon Conference Services. You may now disconnect.
